



What is Purchase Order Finance?

Purchase Order Finance (POF) is a transaction-specific form of working capital/trade financing. It is an advance against the value of a purchase order or contract to enable the borrower/supplier to pay for inputs, raw materials, packaging, goods for resale, shipping, insurance, etc. needed to produce and ship a product or deliver a service. It is not a loan or line of credit for general operations. POF helps businesses fill larger and/or more frequent orders, become more profitable and competitive, and hire more employees. It can be used to help companies finance both domestic and export sales. POF is very flexible and can be tailored to the specific needs of the transaction, borrower, lender, value chain, product or service, type of orders/contracts, customer, and available collateral. POF can be used for businesses throughout the value chain, from input, materials and equipment suppliers, to farmers, producers, processors, manufacturers, traders, logistics/transporters, importers/exporters, warehouse operators, wholesalers, buyers, retailers and other final customers. It is well suited to agriculture and agribusiness and for Small and Medium Enterprises (SMEs).

How does Purchase Order Finance work?

A typical Purchase Order Finance transaction works this way:

1. A company obtains a **verified** purchase order or contract from a customer.
2. The company estimates the direct costs (e.g., raw materials, packaging, goods for resale, labor, shipping, insurance, etc.) required to produce and deliver the product or service.
3. The company approaches a lender about financing using the contract as collateral.
4. The lender reviews the order, the cost breakdown and the company's operating record.

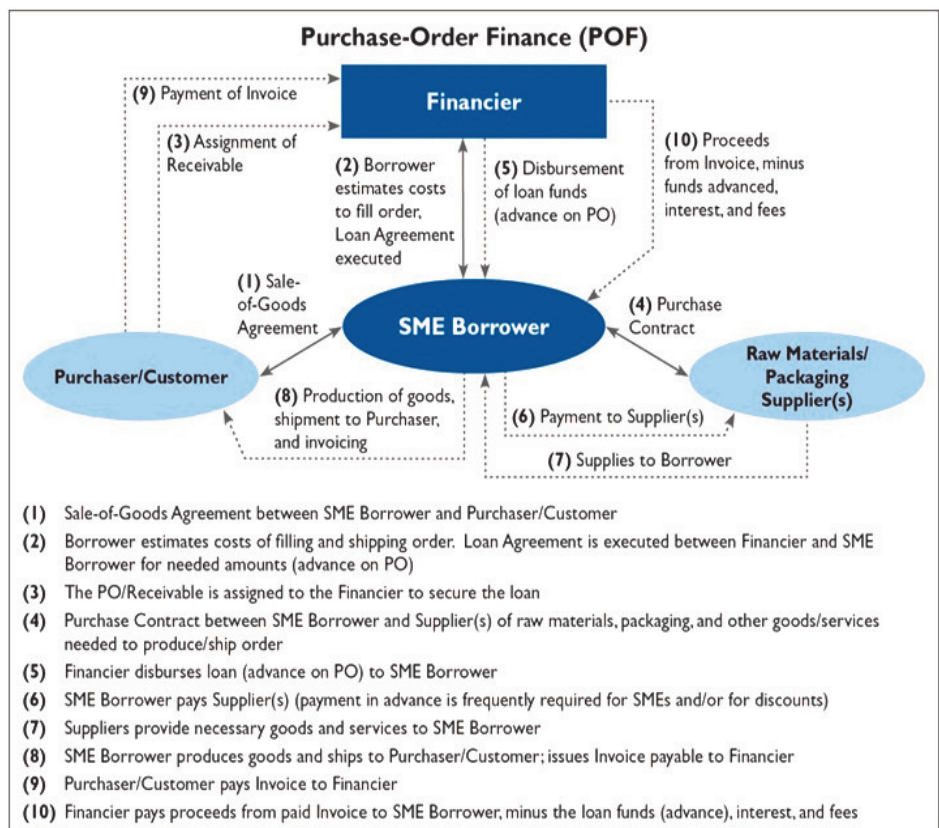
5. The lender evaluates the credit-worthiness of the customer that issued the purchase order and assesses whether the company can deliver according to the terms of the order/contract.

6. If the loan is approved, the lender advances a percentage of the total order value to enable the company to produce and ship the order (or deliver the service) and issue the invoice to the customer.

7. The invoice (accounts receivable) is assigned to the lender, so that payment on the invoice is made directly to the lender.

8. When the customer pays the invoice, the lender is repaid the principal, interest and any fees and remits the balance to the company.

9. This cycle can be repeated over and over with new purchase orders to dramatically increase the sales of the company.



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Launching Purchase Order Finance in East Africa

Small and Medium Enterprises (SMEs) are the backbone of the Eastern and Central African country economies and account for the bulk of food security, sales and employment. However, despite the important role that SMEs play in the regional economy, they remain largely unfinanced and their growth impact on the economy is under realized.

In East and Central Africa, as in many emerging economies, banks view SME lending as risky and costly (setting interest rates and collateral requirements prohibitively high to reflect this perceived risk and cost) and the underwriting requirements of most banks make loans out of reach for many SMEs. This financial bottleneck negatively impacts the growth and employment potential of SMEs in the region.

POF is also sometimes referred to as “contract finance”, “pre-shipment finance”, or “vendor finance”. When it is used to finance domestic sales it is sometimes referred to as local purchase order finance (LPO). In East Africa, the USAID funded COMPETE project is helping financial institutions either introduce POF or enhance the utilization of POF for key value chains and businesses including agriculture and SMEs for regional trade. COMPETE’s partner implementing firm Crimson Capital has recently helped three financial institutions in South Africa launch POF. A couple of example POF transactions are described below.

Franchise Sector Financing in South Africa. A franchising company in South Africa with 220 franchisees wanted to get new equipment and materials to the franchisees but didn’t have the working capital to buy everything needed at once, distribute to the franchisees and then wait for payment. Under the USAID funded Financial Sector Program (FSP), Crimson Capital helped a South African financial institution launch POF. The institution provided a US\$ 180,000 POF loan advance to the franchisor to enable it to buy the equipment and materials and deliver them to the franchisees against purchase orders from the franchisees.

The POF financing enabled the franchisor to help its franchisees upgrade and offer new products and services to their customers and increase sales and profits for both the franchisor and the franchisees.

The institution is now offering POF financing to its other franchisors as well as businesses and SMEs in other sectors and value chains.

Coffee Sector Financing in Bolivia. A coffee producer association representing 260 growers received an order from a Dutch company for 19.6 MT of organic washed Arabica. The association and the Dutch buyer agreed to a price of US\$ 55,664 (\$2.84/KG); however, because the association lacked the financial resources to fill the order, they were reluctant to commit to the contract.

With technical support from Crimson Capital under the USAID-funded Rural Competitiveness Activity (ARCo), FIE, a Bolivian financial institution, provided a US\$ 30,000, 12% annualized, 90-day financing advance to the association through a POF loan (actual interest paid was only for the 90 day period - the amount of time the association needed the advance). The advance was used to process the coffee and cover other pre-shipment expenses, allowing the association to take advantage of this opportunity. The association assigned the invoice for the transaction to FIE FFP along with an invoice from a previous export and a portion of its savings deposited at FIE as security.

According to the cooperative’s manager, “Purchase order financing allows us to use our own product to collateralize exports and fill more demands. This is a real innovation, a financial facility that ultimately benefits all our members.”

Based on the success of this initial transaction, FIE rolled out POF to other value chains such as palm heart, cocoa, pineapple and banana, and from the rural areas of Yungas and Chapare to the entire country.

“Crimson’s development of a new purchase order financing mechanism is a major breakthrough in Bolivia. Over the past fifteen years, no Bolivian regulated financial institutions have been willing to provide financial services to alternative development agricultural clients. USAID appreciates the complexities, challenges and strides made by Crimson Capital in enticing Bolivian financial entities to undertake financial activities with their own capital and at their own risk in the Chapare and Yungas regions.” (Peter Natiello, USAID Bolivia)

USAID COMPETE is working with financial institutions in East Africa to increase the use of POF for the targeted regional value chains of Staple Foods (SF), Specialty Coffee (SC); and Cotton, Textiles and Apparel (CTA). For more information on Purchase Order Finance or the East Africa Purchase Order Pilot Program please contact:

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